

Income/Franchise:

Texas: COGS Deduction and Reduced Rate Do Not Apply Given Receipts Were Derived from the Sales of Services Rather than Goods

SOAH Docket No. 304-24-15211 [CPA Hearing No. 119,652], Tex. Comptroller of Public Accounts (12/4/24). The Texas Comptroller of Public Accounts adopted a proposal for decision issued by a Texas administrative law judge (ALJ) with the State Office of Administrative Hearings, affirming an underlying audit assessment whereby the taxpayer's revenue from bundled "printing as a service" (PaaS) was determined to constitute revenue from services rather than retail sales; therefore, the taxpayer was *not* allowed to deduct costs related to the PaaS as cost of goods sold (COGS) in computing its Texas franchise tax base and ineligible for the Texas franchise tax's reduced tax rate for retailers and wholesalers. In the decision, the ALJ explained that if a transaction contains elements of both a sale of tangible personal property and a service, a taxable entity generally may subtract as COGS the costs otherwise allowed in relation to the tangible personal property sold. Here, while the taxpayer's PaaS sales constituted a bundle of printing services and tangible personal property, the ALJ concluded the taxpayer failed to meet its evidentiary burden based on an absence of documentation demonstrating "what pieces of equipment were transferred to its customers, when they transferred, and the cost of purchasing the equipment." Accordingly, the adopted decision upheld the auditor's revised COGS calculations for the taxpayer. For similar reasons, the decision concluded the taxpayer failed to establish it was primarily engaged in wholesale or retail sales, and, thus, was ineligible for the reduced franchise tax rate for retailers and wholesalers. Please contact us with any questions.

URL: <https://star.comptroller.texas.gov/view/202412006H>

— Robert Topp (Houston)
Managing Director
Deloitte Tax LLP
rtopp@deloitte.com

Grace Taylor (Houston)
Senior Manager
Deloitte Tax LLP
grtaylor@deloitte.com

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